

APPROVED MINUTES
APPROVED 08-19-13
CITY OF SCOTTSDALE
AUDIT COMMITTEE



MONDAY, JUNE 17, 2013

CITY HALL
KIVA CONFERENCE ROOM
3939 NORTH DRINKWATER BOULEVARD
SCOTTSDALE, AZ 85251

REGULAR MEETING

PRESENT: Suzanne Klapp, Chair
Virginia Korte, Council Member
Robert Littlefield, Council Member

STAFF: Bruce Washburn, City Attorney
Dan Worth, Acting City Manager
David Smith, City Treasurer
Liz Hildenbrand
, Community Services Division
Bill Murphy, Community Services Division
Reed Pryor, Community Services Division
Joyce Gilbride, Finance & Accounting Division
Anna Henthorn, Finance & Accounting Division
Brad Hartig, Information Technology Department
John Cocca, Police Department
Helen Gandara, Police Department
Darcy Nichols, Police Department
Derek Earle, Public Works Division
Martha West, Public Works Division
Lai Cluff, City Auditor's Office
Cathleen Davis, City Auditor's Office
Joanna Munar, City Auditor's Office
Sharron Walker, City Auditor

GUESTS: Carter Smitherman, CliftonLarsonAllen
Miranda Wendlandt, CliftonLarsonAllen
Louise Lamb

CALL TO ORDER

Chair Klapp called the meeting to order at approximately 4:00 p.m. A formal roll call confirmed the presence of Committee Members as noted above.

1. Approval of Minutes, Regular Meeting, April 15, 2013

COUNCIL MEMBER KORTE MOVED TO APPROVE THE MINUTES OF THE APRIL 15, 2013 REGULAR MEETING. COUNCIL MEMBER LITTLEFIELD SECONDED THE MOTION, WHICH CARRIED BY A UNANIMOUS VOTE OF THREE (3) TO ZERO (0).

2. Discussion with CliftonLarsonAllen LLP representative regarding the scope and timing of the City's Financial and Compliance Audit for FY 2013

City Auditor Sharron Walker noted that Mr. Carter Smitherman of CliftonLarsonAllen LLP was in attendance and would discuss the financial and compliance audit and, as required by auditing standards, would ask them some questions about oversight. Mr. Smitherman outlined the responsibilities of his firm and of City management in this audit.

He asked the Committee members if any instances of fraud or abuse with the City had been brought to their attention. All confirmed to him that they were not aware of any such instances.

Mr. Smitherman asked whether they had had any fraud-related discussions with any members of City management. Chair Klapp said this is discussed in the Audit Committee meetings in terms of audit reports and risk management, but confirmed there has been nothing of any substance.

Mr. Smitherman clarified that as the City's external auditors, CliftonLarsonAllen ultimately reports to City Council. He inquired about any particular areas of concern they may have. The Committee members concurred there are none.

Mr. Smitherman described the preliminary planning work done in May. They will return in late August and September to audit the financial statements. They expect to issue a report to management by the end of October. He assured them that if anything comes up where he is required to make any sort of communication in the meantime, he will advise them either directly to the Committee or through the City Auditor's Office. If they have any questions about the process or government financing and accounting in general, he urged them to call him at any time.

Council Member Littlefield asked what CliftonLarsonAllen would do if they received a concern about impropriety from someone outside the City. Mr. Smitherman said if a citizen were to contact them, they would reach out to the City Auditor's Office to communicate and coordinate with them. He said people have phoned them to request a copy of the CAFR. The firm does not disclose any confidential information, but directs these inquiries to either Finance or the City website. In response to a follow-up question from Council Member Littlefield, Mr. Smitherman said if a citizen had a concern about the City Auditor's Office, he would come directly to the Audit Committee.

3. Discussion and Possible Direction to Staff direction to staff regarding Audit Report No. 1309, Tournament Players Club Lease Agreement

Ms. Lai Cluff of the City Auditor's Office presented the report. She noted that the timing of certain accounting entries made by the TPC Scottsdale corporate office and minor errors in rate calculations caused small dollar exception totaling approximately \$3,600. However, the value of complimentary rounds given to TPC employees and for promotional and marketing purposes is not specifically addressed in the lease agreement and was not included in revenues or rent calculations. Approximately seven to eight percent of total rounds played at the TPC from January 1, 2011 through the end of March 2013 were complimentary. The auditors estimated the value of these rounds to be about \$2.1 million, which would equate to \$239,000 in rent and Basin Management Fund surcharges to the City.

Additionally, an amount required by a 1995 lease amendment to be added to the rent calculation has not been included. The TPC Scottsdale indicated this amount may have been added to repay the City for a land purchase that was subsequently repaid directly, rather than through the lease agreement. However, at this time records are not available to substantiate why this amount is not being included. As a result it appears rent has been underpaid by about \$11,000 for the last two and a quarter years.

As well contract administration oversight over lease payments and compliance with other contract terms can be improved. Specifically the contract administrator should perform an annual verification of TPC reported revenues, ensure rate increases are appropriately approved, monitor the BOR's priority reservation restrictions, require TPC Scottsdale to report its own BOR approved surcharges and pay specified capital project costs, and not personally handle the rent payments, as it is inefficient and increases the risk of loss.

Noting that allowing employees to play complimentary rounds is a widespread practice at golf clubs, Council Member Korte inquired how the value of complimentary rounds was calculated, noting the large variation between summer and winter rates. Ms. Cluff said they used the average rate from the TPC's annual rounds reports. Auditors selected average resident and non-resident rate categories to better represent what a typical golfer would pay. Ms. Walker added that auditors did not go back through every round played during the 27 months to specifically tie out the values but instead used the average rates to estimate an overall value.

Council Member Littlefield asked if that money should have been paid to the City. Ms. Walker said that is not clear. The report notes that complimentary golf is not addressed in the lease agreement. The audit recommendation is that staff should work with the City Attorney's Office to address this question. The complimentary golf amount is significant enough that it should be addressed. She would defer to the City Attorney's Office as to whether the lease agreement would need to be amended.

Mr. Bruce Washburn of the City Attorney's Office said they are in the process of reviewing the lease agreement and past history with the TPC management to come to a legal conclusion. Mr. Washburn agrees that the agreement does not specifically address the complimentary rounds so it might be a matter of contract interpretation. The City Attorney's Office will work with management to come to some legal conclusions.

When Council Member Littlefield expressed concern about the loss of rental revenue to the City and whether an agreement could be reached with the TPC. Ms. Walker said TPC management was very open with their records during the audit and the General Manager has, in fact, requested that they be audited on a more regular basis. There was no indication that they weren't trying to fulfill the requirements of the contract, so it may be possible for the parties to reach a mutually agreed-upon way to handle the matter. The TPC is doing the rent calculation correctly based on their revenue records, but the complimentary rounds are charged at a zero value so they are not reflected in their revenues. Even though these rounds are rung up at zero dollars, they have a value, and how that is handled needs to be discussed. The audit recommends that management work with the TPC and the City Attorney's Office to address how complimentary rounds should be handled.

Chair Klapp commented that this discussion may result in the TPC recognizing how much revenue they are giving up and change their policies.

Council Member Korte asked whether those rounds were reported as lost sales. Ms. Walker said that they were not. The TPC has very good recordkeeping on the number of complimentary rounds given, but they were recorded at zero value. In fact, their good recordkeeping allowed auditors to quantify and estimate a value for these rounds. Ms. Walker further clarified that the \$2 million amount in the audit report is for 2-1/4 years, not one year.

City Treasurer David Smith cautioned that the City should be somewhat judicious in dealing with this question because the same thing happens with every taxpayer in the City. Anyone who gives an item away instead of selling it is not collecting the sales tax on the item. Chair Klapp agreed that it is a common practice to give something free to employees but it may not be good business practice. But the City does not have a contract with every business in the City like it does with the TPC. Council Member Korte said if this is a standard industry practice, they need to take that into account. Council Member Littlefield said that the question that needs to be answered is whether the City deserves to be paid for these rounds based on the agreement. It sounds like the answer is not clear. Chair Klapp commented that it could also be something different going forward. Mr. Washburn agreed with Council Member Littlefield's comment that it is a legal question for Mr. Washburn to address.

4. Discussion and Possible Direction to staff regarding Audit Report No. 1310, Citation Controls

Ms. Joanna Munar of the City Auditor's Office reviewed the report. The auditors evaluated the Police Department's controls over ordering, securing, issuing and accounting for the Department's citations. Other areas in the City authorized to issue citations, such as Code Enforcement, were not included in the scope of this audit.

In general once a citation is issued by an officer, it is reviewed by the officer's supervisor and then sent to the records unit to be entered into the Police Department's record management system, I/LEADS. The citation is then reviewed for completeness and when approved it is transmitted to the court having jurisdiction. The timeliness of this process is important to comply with Arizona statute and to reduce the risk of citations missing the scheduled court hearings, because that normally results in dismissed

charges. Only a judge or hearing officer of the appropriate court can dispose of a citation through a trial or other official action. It is unlawful for a police officer or other public employee to dispose of a citation.

The audit found that the established procedures for handing citations provide a reasonable level of accountability. Improvements can be made by ensuring that all electronic and in-custody citations are entered in I/LEADS, that the monthly internal review of citations required by statute includes voided citations, and that supervisors ensure that police officers provide timely and accurate responses to inquiries by the Records Unit. The auditors found more gaps related to the final disposition of electronic and in custody citations.

For the exception reports of pending, not-in-system and past due citations to be less voluminous and provide effective management information, the disposition data in the I/LEADS system must be complete and accurate. Finally, certain citation data fields in I/LEADS can be defined more specifically so that the information is more consistent. Duties over and access to electronic citation records should be properly separated to ensure that no one person has the ability to erase all evidence of a citation.

Chair Klapp said it seems the electronic citation device does not link to I/LEADS. She asked if there are plans to connect the devices with the system and avoid manual data entry. Records Manager Ms. Darcy Nichols confirmed that currently the hand-held devices do not interface with I/LEADS. They are looking for a vendor of hand-held devices that would have that capability.

5. Discussion and Possible Direction to staff regarding Audit Report No. 1311, Selected Application Controls over the City's CLASS® System

Ms. Cathleen Davis of the City Auditor's Office presented the report, noting that the CLASS® system was implemented in 1997 as the City's Parks and Recreation management software.

The auditors found some opportunities for improvement. Several users have more system access than needed, and authorization processes can be improved. Access to the CLASS® system is granted on a case-by-case basis, but access requests were not formally tracked or documented. User accounts are not reviewed on a regular basis and revoked if appropriate. The auditors found some employees' access to CLASS® had not been based on the individual's regular job responsibilities and the principle of least privilege access. Users are assigned to multiple, sometimes redundant, security groups, and a system administrator user ID and password was used by more than one employee. In addition, some key CLASS® functions have not been reviewed to ensure incompatible duties are separated between two or more users.

The second audit finding was that developing CLASS® change management requirements would provide better assurance that changes had been properly authorized and tested, as change management policies, procedures, roles and responsibilities have not been established. Currently CLASS® system administrators perform testing without a formal testing plan. Developing a comprehensive set of test transactions and data that represent those typically encountered in day-to-day system

use would provide better assurance that testing can identify any errors or incompatibilities in system changes.

Finally, the auditors found that certain improvements can be made to better protect CLASS®. Measures such as password parameters, CLASS® training plans, user monitoring, and business continuity planning can be brought into better conformance with information security best practices.

6. Discussion and Possible Direction to staff regarding Audit Report No. 1302, Annual Follow-up on Status of Audit Recommendations

Ms. Walker presented the annual follow-up report. She noted that the implementation status for the City is at 97.3%, which is very high compared to performance measure she routinely sees from other auditors. She is considering refining the database to track recommendations in more specific detail. A teen volunteer is working on this project over the summer.

7. Discussion and Possible Direction to staff regarding the Proposed FY 2013/14 Audit Plan

Ms. Walker presented the most recent update to the proposed audit plan. She noted that the audit plan is a balance of larger and smaller projects considering available resources. The City Auditor's goal is to conduct 15 audits in the course of the next fiscal year; if those are completed, auditors would start on the contingency audit list. However, auditors will probably not have time to tackle the items on the contingency list and all of the proposed audits are considered worthwhile to include this year, so Ms. Walker asked the Committee if there are items on the contingency list they believe should be moved up. Ms. Walker responded to Chair Klapp's question that one of the three listed lease agreements will be selected for this year's audit and welcomed the Committee's input.

Council Member Korte said she would like the Fire Department staffing model audit moved up onto the plan. Ms. Walker said the audits on the plan are listed in risk order so she would suggest dropping the last item on the list to accommodate this audit, unless the Committee members have additional input. The Committee members agreed that the Scottsdale Stadium lease agreement should be selected for this year, and the other two lease agreements should be placed on the contingency list. Because the contingency list will probably not be completed this year, Ms. Walker will put another lease agreement audit on next year's plan.

Council Member Littlefield suggested moving the audit of accounts receivable from the contingency list to the audit plan. Chair Klapp concurred. Council Member Korte said she is concerned about the Fire Department staffing, given the City's budget process and that staffing was increased with unsustainable dollars. Council Member Littlefield said any audit relating to collecting cash for the City should be a priority; they need to be sure that the City is collecting everything it should.

Ms. Walker said she could move items 14 and 15 from the audit plan onto the contingency list and replace them with the Fire Department staffing model and accounts receivable audits.

Council Member Littlefield asked about the revenue value involved with the wireless communications facilities, which was the last item on the audit plan list. After discussion, the Committee members concurred that it would make sense to move that audit to the contingency list.

The discussion turned to item 14 on the audit plan, Water Department key water treatment supplies, which has never been audited. Each year, Ms. Walker includes some new areas as well as revisiting others that merit additional work. Council Member Littlefield commented that the audit of the McCormick-Stillman Railroad Park, item 11, could be postponed in favor of another audit potentially involving more money.

The Committee members concurred that items 11 and 15 should be moved to the contingency list and that the audits of accounts receivable and the Fire Department staffing model should be placed on the audit plan.

Ms. Walker commented that if priorities change during the course of the year the Committee can authorize changes to the plan, at either the City Auditor's initiation or the Committee or Council's.

8. Discussion and Possible Direction to staff regarding status of FY 2012/13 Audit Plan

Ms. Walker reported that they have completed everything on this year's plan and have started working on the wastewater rate classification review, which was at the top of this year's contingency list. Her staff has done an outstanding job throughout the year to complete the entire audit plan.

9. Discussion and Possible Direction to staff regarding agenda items for next Audit Committee meeting (August 19, 2013)

The next meeting on August 19th will start at 3:30 p.m. as it is on the same day as the first City Council meeting after the summer hiatus. The agenda includes two sunset reviews, the quarterly Taxpayer Problem Resolution Officer report, and the Wastewater Customer Rate Classification Review.

Public Comment

No members of the public wished to address the Committee.

Adjournment

The meeting adjourned at approximately 4:54 p.m.

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